IN THE

Supreme Court of the United States

October Term, 1979

No. 79-793

HOUSTON LIGHTING AND POWER COMPANY, et al.,
Petitioners,

v.

INTERSTATE COMMERCE COMMISSION, et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT RAILROADS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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QUESTION PRESENTED

The Court of Appeals in the decision below affirmed decisions and orders of the Interstate Commerce Commission holding that capital incentive rates proposed by the railroads for transportation of coal in unit trains to Smithers Lake, Texas (near Houston) and Cochise, Arizona, did not exceed a maximum reasonable level, and were not otherwise unlawful. The question presented is whether the Court of Appeals erred in concluding that the Commission's decisions complied with the statutory Rule of

Ratemaking[1], reflected proper consideration of the relevant ratemaking factors, and were not arbitrary or capricious.

STATEMENT OF THE CASE

Railroad Respondents[2] and other railroads throughout the United States are increasingly called upon to transport large volumes of coal to the generating plants of electric utilities. To handle these coal movements in unit trains consisting of many heavily-loaded cars, the railroads must spend hundreds of millions of dollars to upgrade their lines and to purchase new locomotives for service in the unit train coal movements.[3] The need for these expenditures has arisen in a period of declining financial strength for the railroads.

In Section 206 of the 4-R Act of 1976, adding Section 15(19) to the Act (now recodified as 49 U.S.C. § 10729), Congress provided a new procedure governing proposed rates in situations where implementation of the rate proposal would require a total capital investment of $1,000,000 or more. Section 206 was intended to encourage major capital investments by assuring the railroads that if a capital incentive rate proposal was not determined by the Commission to be unlawful within 180 days, the

[1]In 1978, the *Revised Interstate Commerce Act* was enacted which, without substantive change, recodified the Interstate Commerce Act (Pub. L. No. 95-473, 92 Stat. 1337, § 3(a)). The Rule of Ratemaking for railroads, set forth in 49 U.S.C. § 15a(4), was recodified as 49 U.S.C. § 10704(a)(2). This new Rule of Ratemaking was originally enacted as Section 205 of the Railroad Revitalization and Regulatory Reform Act ("4-R Act") of 1976 (Pub. L. No. 94-210).

[2]Railroad Respondents herein are Burlington Northern Inc. (including its subsidiaries, The Colorado and Southern Railway Company and Fort Worth and Denver Railway Company), The Atchison, Topeka and Santa Fe Railway Company, and Southern Pacific Transportation Company.

[3]Unit train service is an operating system in which cars and locomotives are used in uninterrupted, round trip, shuttle-type service, and is a highly efficient method of transporting coal in large volumes. See *Potomac Electric Power Co.* v. *United States*, 584 F.2d 1058, 1061 (D.C. Cir. 1978).

railroads could proceed to implement the proposed rate, and to make the associated investment, without the risk that the capital incentive rate might thereafter (for a period of 5 years) be suspended or set aside as unlawful.

On June 3, 1977, Burlington Northern Inc. (BN) and The Atchison, Topeka, and Santa Fe Railway Company (Santa Fe) published a notice of intent to file capital incentive rates applicable to new unit train coal movements from Wyoming to Smithers Lake, Texas (near Houston), where electricity generating plants of Houston Lighting & Power Company (HL&P) are located.[4] The coal would move in unit trains of approximately 100 cars from the mine over the lines of BN and affiliated lines to Fort Worth, Texas, then via Santa Fe to the Houston destination. The total distance is 1607 miles. Annual tonnage was estimated to be approximately 5 million tons.

On June 1, 1977, Santa Fe and Southern Pacific Transportation Company (Southern Pacific) published a notice of intent to file capital incentive rates applicable to unit train movements from New Mexico to Cochise, Arizona, where electricity generating stations of Arizona Electric Power Cooperative (AEPC) are located. The total distance is 523 miles; annual tonnage was expected to be at least 1 million tons.

In the Commission proceedings in both cases, the railroads introduced testimony that they were making investments of

[4]Petitioners state that the railroads were "unwilling to discuss or negotiate their spiraling coal transportation price demands" (Petition, p. 5). That statement is not correct. The railroads and the shippers did in fact negotiate, although they were unable to reach agreement (see Court of Appeals Appendix, Verified Statements of Witnesses Davis, pp. 34–40 and Grygiel, pp. 15–17).

Likewise Petitioners' suggestion that the railroad engaged in "bait and switch" tactics is untrue (*id.*).

far more than $1 million in equipment and fixed plant improvements.[5]

In addition to demonstrating that they would invest more than $1 million because of each new movement, the railroads introduced voluminous evidence with respect to the operating characteristics of the new movements, the costs of service including capital costs, the railroads' revenue needs in light of the vast amounts of capital needed to transport the huge anticipated volumes of coal,[6] rates charged for other comparable coal movements, and other related matters. The railroads and the electric utilities disagreed as to whether the proposed rates qualified for capital incentive treatment, and also as to what were the costs of performing the service and the relationship (if any) railroad rates should bear to costs.

The Commission found in both cases that the railroads' proposed rates met the $1 million capital investment requirement under Section 15(19) (now Section 10729). It then analyzed the proposed rates in light of the railroads' revenue needs, costs of service, and rate comparisons, and concluded that the rates were within the zone of reasonableness.

The Court of Appeals, in a unanimous decision written by Judge Leventhal, affirmed the Commission's decisions and orders.

[5]Locomotives used in unit train coal service cost in excess of $500,000 apiece. The railroads were required to acquire 69 such locomotives because of the Houston movement and 8 because of the Arizona movement. The total new investment in the case of the Houston movement exceeded $69 million. In the case of the Arizona movement, total new investment exceeded $12 million.

[6]In 1976 (the most current year for which data were then available), BN's rate of return on equity was 4.2 percent, Santa Fe's was 4.2 percent, and SP's was 5.3 percent—returns which were obviously inadequate at a time when *debt* rates were in the range of 8 percent and equity returns were far higher. (HL&P, which is a franchised electric utility and a far less risky investment than the railroads, in 1976 earned a return of 14.7 percent on its equity after provision for income taxes.)

The first group of issues addressed by the Court of Appeals related to whether the proposed rates qualified for capital incentive rate treatment. This was the question to which Petitioners had devoted approximately two-thirds of their briefs before the Court of Appeals; and it occupies a major part of the Court of Appeals' decision (Part II, App. pp. 8a–20a). The Court of Appeals concluded that the proposed rates did qualify for capital incentive treatment.

The petition for certiorari filed by Petitioners does *not* seek review by this Court of the decision below that the railroads' rates qualified for capital incentive treatment.

The second group of issues addressed by the Court of Appeals related to whether the proposed rates were within the zone of reasonableness (App. pp. 26a–34a). The Court of Appeals concluded that the Commission's determinations "reflect full consideration of the evidence and the salient factors" (p. 26a)—including comparable rates (p. 26a), cost evidence (p. 27a), the railroads' need to attract equity capital (p. 28a), and public interest considerations (p. 33a). It then concluded that, "In our view, the Commission has given due consideration in these cases to the relevant factors entering into a determination of reasonableness" (p. 36a).

ARGUMENT

Petitioners assert that the cases as to which review is sought "are the tip of a mushrooming iceberg." (Petition, p. 9). However, their argument is as unsound as their metaphor.

These cases do not present a situation where the decision below is "in conflict with the decision of another court of appeals on the same matter" (Rule 19 of the Rules of the Supreme Court of the United States). There has been no other decision of a court of appeals passing on the validity of a Commission decision approving proposed capital incentive rates.

Nor do Petitioners identify any "important question of federal law" which should be decided by this Court, or which has been decided by the Court of Appeals below in a manner contrary to decisions of this Court.

Petitioners argue that the pricing of coal transportation "is too important to the national interest to go by default." (Petition, p. 9). However, the lawfulness of the two rates involved here is *not* a matter which has gone "by default." The Commission carefully considered Petitioners' arguments that the involved rates were excessive; and the Court of Appeals unanimously affirmed the Commission's orders in a decision which is both careful and comprehensive.

Petitioners also assert that the Commission's orders have "heralded a new era of railroad rate regulation which is totally without metes, bounds, or recognizable principles" (Petition, pp. 9–10). This assertion is not correct. The Commission in these cases did *not* adopt any particular formula approach to determining what is a maximum reasonable rate. It was unnecessary in these cases to determine the maximum level of reasonableness because the involved rates were well below the maximum end of the zone of reasonableness.[7]

In other recent coal rate proceedings (decided long after the decision in the present cases), the Commission has adopted a formula approach in determining the level of maximum

[7]Traffic generally must bear rates which on the *average* cover fully allocated costs, including cost of both equity and debt capital, in order for railroads to attain the standard of revenue adequacy established by Congress in the new Rule of Ratemaking for railroads (49 U.S.C. § 10704(a)). The Houston rate of $15.60 was found to be less than 100 percent of fully allocated costs, including cost of capital reflecting cost of equity as well as cost of debt capital ($16.07; App. p. 24d). The rate-to-variable cost ratio of the Houston rate (using variable costs as determined by the Commission using embedded debt rates) was 163 percent (App. p. 22d); the Arizona rate-to-variable cost ratio was even less, 159 percent (App. p. 17c).

reasonableness. In these cases, the Commission has held that the level of maximum reasonableness may be found by multiplying fully allocated costs of service by a factor of 1.07. Both shippers and railroads have filed petitions for review of these decisions in several courts of appeals (among those listed in Appendix H). However, the Commission did *not* apply any such formula approach in the Houston or Arizona cases. Petitioner's references to the Commission's decisions in these other cases as "unreasoned" or "fluctuating", or even as lacking "rhyme or reason" (Petition, p. 10), have no bearing on the present cases and thus do not constitute reasons to grant the petition for certiorari in this case.[8]

Similarly, Petitioner's reference to the Congressional testimony of a representative of the United States Department of Energy with respect to the impact of coal rates on national energy policy (Petitions, p. 11) is not a reason to grant the petition in this case.[9]

[8]Petitioners' statement that the issues in these other coal rate cases are "identical to the cases here" (Petition, p. 11) is wrong. The validity of the Commission's "107 percent solution"—applied on an interim basis in certain coal rate cases decided since May 1979—is not at issue in the instant cases. (Indeed, the Houston rate was found to be less than 100 percent of fully allocated costs. See *supra* p. 6, fn.7)

[9]Congressman Eckhardt's brief as amicus curiae argues that the rates approved by the Commission threaten national coal conversion policy (Brief, p. 20 et seq.). This argument was *not* made to the Commission in these cases by any party. However, it has been made in other coal rate proceedings before the Commission; and in these other cases the railroads have shown that the rates they propose will not have an adverse effect on national energy policy.

Petitioner's statement that the "I.C.C. itself has verified" that escalating coal rates cause coal usage to shrink (Petition, p. 11)—citing a *draft* Environmental Impact Statement prepared by the Commission's Energy and Environmental Branch which is a *party* to the proceeding before the Commission in which the draft was prepared (a proceeding which is continuing and in which the Commission has announced *no* decision)—is not only inapplicable to these movements, but is also a serious misstatement.

Petitioner contends that the Commission erred in giving too much weight to the revenue needs of the railroads (Petition, p. 12). However, the Commission did not give exclusive weight to railroad revenue needs, it considered other factors—including rate comparisons (p. 26a), cost evidence (p.27a), and public interest considerations (p. 33a). Moreover, it would have been clear error for the Commission, *not* to have given weight to railroad revenue needs. The new Rule of Ratemaking for railroads enacted as part of the 4-R Act in 1976 *directed* the Commission to "make an adequate and continuing effort to assist" the railroads attain revenue adequacy. "Adequate" revenue levels were defined by Congress to be revenues adequate to cover operating expenses "plus a fair, reasonable, and economic profit or return (or both) on capital employed in the business," including a return level that would "permit the raising of needed equity capital." The principal purpose of this new Rule of Ratemaking was to allow the railroads greater flexibility in setting and modifying rates, so that they could attract capital in the private capital markets and thus rehabilitate their physical facilities and provide needed service to the public.[10] In light of this statutory mandate, the Commission could not lawfully disregard the revenue needs of the railroads in determining maximum reasonable rate levels.[11]

[10]Section 101 of the 4-R Act states that the purpose of the 4-R Act was "to provide the means to rehabilitate and maintain the physical facilities, improve the operations and structure, and restore the financial stability of the railway system of the United States, and to promote the revitalization of such railway systems, so that this mode of transportation will remain viable in the private sector of the economy . . . ." (Section 101(a), 45 U.S.C. § 801(a)).

The legislative history of the 4-R Act fully confirms Congress' concern with restoring the railroads to financial health. The House Committee on Interstate and Foreign Commerce, which reported favorably on the bill that became the 4-R Act, stated (Report on H.R. 10979, H.R. Rep. No. 94-725, 94th Cong., 1st Sess. at 54 (1975)):

> "Every study that has been done, indicates that within the next eight to ten years, the railroads are going to experience new cash shortfalls. Estimates of the shortfalls range from the ICC's low of $3.6 billion, to a high of $21.1 billion, which is the First National City Bank's estimate. With these projections, it is obvious that the

(footnote continued on following page)

Finally, Petitioners argue that if its petition is denied, they will get no "second chance" (p. 16). However, to allow Petitioners the "second chance" they seek would violate the terms and purposes of Section 10729. The capital incentive rate provisions of the Act (Section 10729) provide that if a proposed capital incentive rate is not found by the Commission to be unlawful within 180 days of the date it is filed, "such a schedule may not, for a period of 5 years after its effective date, be suspended or set aside

(footnote continued from preceding page)

> railroads are not going to be able to repair their tracks. The marginal railroads are going to go under because they cannot offer competitive services. The lack of available funds will only result in more deferred maintenance, more disinvestment in the railroad industry, and eventually more bankruptcies."

[11]Congressman Eckhardt suggests that although the new Rule of Ratemaking contained in the 4-R Act had become effective on February 5, 1976, the Commission was somehow *precluded* from even considering railroad revenue needs until the completion of the Commission's rulemaking proceeding instituted to promulgate standards and procedures for establishing adequate railroad revenue levels (Brief, pp. 10–13). The Commission issued its report in that proceeding in early 1978. *Standards and Procedures for the Establishment of Adequate Railroad Revenue Levels,* Ex Parte No. 338 (decided January 31, 1978, served February 3, 1978). However *nothing* in Section 205 of the 4-R Act (now Section 10704(a)(2)) states, or even suggests, that the Commission was forbidden to consider railroad revenue needs prior to the time the rulemaking was concluded.

Indeed, quite the reverse is true. Congress directed the Commission to make "an adequate and continuing effort" to assist the railroads in attaining revenue adequacy. Under Congressman Eckhardt's construction of the Act, Congress passed a bill to prevent any further collapse of the nation's railroad system—but required the Commission to allow the collapse to continue for 24 more months while it completed a rulemaking proceeding to define "revenue adequacy"—a construction belied by both the plain terms and clear purpose of the 4-R Act. (Indeed, by Congressman Eckhardt's theory, there was no statutory Rule of Ratemaking for railroads for two years.) No such argument was even suggested to the Court of Appeals below.

as unlawful under section 1, 2, 3, or 4 of this title . . . ." The purpose of this provision was to encourage major railroad investment by eliminating the delays and uncertainties associated with litigation before the Commission and in judicial review proceedings.[12] In both of these cases, the 180-day periods expired in November 1977. The railroads have made the capital investments contemplated by the Act in reliance on the Commission's approval of their rates. Moreover, Petitioners have now abandoned any argument that those rates are not proper capital incentive rates (see *supra,* p. 5). Thus, no question at all—let alone any serious question—is presented as to the protected character of these rates under the capital incentive provisions of the Act.[13] Accordingly, Petitioners are not entitled to a "second chance" to attack the rates applicable to their coal movements.

CONCLUSION

The railroads have invested hundreds of millions of dollars in order to handle huge new volumes of Western coal, and tens of millions to handle the Houston and Arizona movements at issue here. To raise this needed capital in the private financial markets, the railroads must dramatically improve their rates of return. The Commission in these cases approved rates which approximately cover the fully-allocated costs of service, including cost of capital (equity as well as debt). Its decisions were clearly not arbitrary or

[12]*See* Report of the Senate Committee on Commerce on S.2718 (Report No. 94-499), 94th Cong., 1st Sess. (1975), pp. 11-12.

[13]Petitioners' suggestion that this Court should defer action on their petition until such future time as some other coal rate case is "taken up by the Court" (Petition, p. 17) assumes without basis that some future case will be "taken up." Moreover, the other rate cases are different—involving different parties, different records, and in some instances different analysis (see *supra,* pp. 6-7). Putting aside Petitioners' assumption that all coal rate cases present the same "inextricably related economic, political, and even military" issues (Petition, p. 17), there is no basis whatever for Petitioners' speculation that the *legal* issues presented in such future cases will be the same as those resolved in these cases by the Court of Appeals below.

irrational. The Court of Appeals was clearly correct in affirming the Commission's orders. Disapproval of these rates would have been inconsistent with the statutory requirement that the railroads be permitted to charge rates which cover their costs plus a fair return that will "permit the raising of needed equity capital" and assure the existence of "a sound transportation system in the United States."

For the foregoing reasons, the requests by Houston and Arizona for issuance of a writ of certiorari should be denied.

Respectfully submitted,

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